

# ICPS newsletter

## Ukrtelecom's huge social obligations stifle development of the communications sector

***In Ukraine, the development of the communications sector depends heavily on the standing of the dominant operator—the Ukrtelecom OJSC, which is the biggest operator in the sector, services 9 million customers, controls the backbone communications network, and provides network access services to other operators. Conditions of the network affect the quality of services provided by both Ukrtelecom and other telecoms operators. However, Ukrtelecom has limited possibilities to investing in developing and upgrading its network. As a result, Ukraine lags behind Central and Eastern European countries by its telephone penetration level***

### Why are Ukrtelecom's investment possibilities limited?

We should point out the following two main reasons triggering this situation:

*Ukrtelecom's social and commercial functions are not separated*

Extant legislation imposes the state's social obligations upon the Ukrtelecom OJSC—those of delivering communications services as well as ensuring employment. These obligations are listed in Table 1. Ukrtelecom provides services in unprofitable state-protected market segments (including rural telephone communications, connections to/from geographically remote and hard-to-access regions, and services to protected population groups). Concurrently, the legislation does not envisage any special mechanism for offsetting Ukrtelecom's losses from providing these services (except for the budget-financed compensation of losses due to the communications services delivered to privileged categories of the population).

### *Unrealistic budgets of Ukraine*

Over Q1-Q3'02, Ukrtelecom's losses from service delivery to privileged categories amounted to 83 million UAH. For this same period, Ukrtelecom obtained reimbursements of 48 million UAH from the budget. The company bridged the gap by diverting money earmarked for other

purposes, in particular, investments. The bulk of declared state benefits is not targeted, which is supported by the fact that the volume of received benefits actually increases proportionately to household incomes. As of 1 October 2002, total budget refunds for communications service deliveries owed Ukrtelecom amounted to 199 million UAH. Unrealistic budgets have become a pretext by many budget-funded institutions and organisations for not paying for the services provided by Ukrtelecom. As of 1 October 2002 accounts payable of budget-funded institutions to Ukrtelecom amounted to 330 million UAH (45% of Ukrtelecom's accounts receivable for communications services).

### Implications

#### *Implications for Ukrtelecom*

- The Ukrtelecom OJSC cannot develop or implement a comprehensive commercial strategy, aimed at increasing the company's value for its owner, the government. Ukrtelecom sustains losses, and thus cannot invest in network expansion or upgrading; moreover, delays in upgrading cause Ukrtelecom's maintenance expenditures to pile up.
- Ukrtelecom loses out in profitable market segments competing with new operators, who do not assume any social obligations and do not have to deal with the burden of an inherited ineffective

network; hence, they can focus solely on capturing profitable market segments.

#### *Implications for new operators*

- Due to the network's lack of development, Ukrtelecom demands that new operators perform additional construction at their own expense. This is the only way for Ukrtelecom to compensate losses from the fulfilment of social obligations; however, new operators regard these actions to be a breach of competition rules. Thus, opposition escalates between Ukrtelecom and new operators.
- Ukrtelecom's network is not evolving, which does not allow new operators to enjoy high-quality network access services.

#### *Implications for the State Communications Committee*

- The State Communications Committee (Derzhkomzviazok) is losing its strategic function, replacing it with the function of protecting Ukrtelecom to enable it to continue fulfilling its social functions. Since competition is creating ever greater pressure, Derzhkomzviazok is working more and more often in "fire-fighting" mode. In such cases, the committee is not developing its capacity for policy formulation in the sector, nor for the implementation of regulations.

#### *Implications for society as a whole*

- Public dissatisfaction with regard to accessibility and quality of communications services is mounting; in particular, this results from exaggerated expectations, based on the requirements of Ukrtelecom declared in legislation.
- The telecommunications network is not developing, and the quality of services is not improving, either.

## Recommendations

In order to eliminate these adverse effects, their causes should be removed, that is, (1) Ukrtelecom's commercial and social functions should be separated; and (2) only realistic budgets should be adopted. To these ends, we recommend the following measures:

### Short-term measures:

- when doing business planning, Ukrtelecom should address social obligations separately, assessing their volume and planning measures to minimise spending and maximise revenues from providing services to socially protected categories of the population;
- to initiate legal proceedings against budget-funded institutions and organisations that have debts for consumed services, and unilaterally seize these debts pursuant to court judgements (at the same time, pursuant to legislation, continue providing communications services to these organisations);
- to lobby the cancellation of benefits for communications services extended to certain categories of the population in the Law of Ukraine "On the State Budget for 2003".

### Mid-term measures:

- to lobby for the repeal of legislative acts which impose excessive obligations upon the Ukrtelecom OJSC;
- to support the enactment of the Cabinet of Ministers of Ukraine Resolution dated 2 March 2002 "On the approval of the Strategy for Replacing the System of Benefits with Targeted Financial Aid to the Population";
- to lobby for the creation of a Fund for Universal Services (universal access), from which operators' losses from providing universally accessible services will be offset.

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**Table 1. Obligations imposed upon the Ukrtelecom OJSC under extant legislation**

Normative act	Description of obligation	Implication
Law of Ukraine "On communications" (part 13, article 14)	Ukrtelecom is obliged to provide discounted communications services to specific categories of the population that are defined in other laws	Whereas most benefits are not targeted, Ukrtelecom sustains unfair losses
Law of Ukraine "On the peculiarities of privatisation of the Ukrtelecom Open Joint-Stock Company" (part 2, article 14)	Ukrtelecom (unlike other operators) provides communications services to privileged categories regardless of the government's ability to refund the cost of these services	Ukrtelecom is forced to finance service delivery to privileged categories at the expense of diverting its investment funds
Law of Ukraine "On the peculiarities of privatisation of the Ukrtelecom Open Joint-Stock Company" (part 1, article 14); Law of Ukraine "On communications" (part 9, article 14)	Usage of communications services provided by Ukrtelecom cannot be prohibited or restricted for the Verkhovna Rada of Ukraine, or for state bodies in charge of national security and defence of Ukraine	Discourages budget-funded institutions and organisations from paying for communications services
Law of Ukraine "On the temporary prohibition of penalising citizens of Ukraine for late payment of fees for communications services"	Until the problem of paying out debts on pensions, stipends, etc. is resolved, it is prohibited to accrue and seize penalties from citizens of Ukraine for overdue payment of fees for communications services	Discourages timely payment for communications services
Law of Ukraine "On the privatisation of state property" (article 26)	Ukrtelecom, as a company to be privatised, is prohibited to terminate labour contracts with its employees (save for specific cases). This prohibition is in effect starting from the date of adoption of the privatisation decision till six months after the ownership rights are transferred to a new owner	It does not pay to upgrade the network. Installing digital ATEs will require less labour to service them, but Ukrtelecom cannot lay off its employees
Order "On approving maximum tariffs for basic telecoms services and tariffs for the payment of state pensions and pecuniary aid" No. 120 dated 07.06.02	Reduction coefficients for connection fees and subscription fees for the rural population were set (while the cost of installing lines in rural area is higher than in urban areas); per-minute tariffs for telephone calls in rural areas are almost half those in urban areas. Tariffs for budget-funded institutions and organisations were reduced. The subscription fee for main radio port is 0.42 UAH (ex VAT). This tariff has not been altered since 16 September 1998	Provision of rural telephone services and wired radio communications is loss-making

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